J.K. LASSER'S
YOUR INCOME TAX

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Publisher's Note: *Your Income Tax* is published in recognition of the great need for clarifications of the income tax laws, for the millions of men and women who must make out returns. We believe the research and interpretation by the J.K. Lasser Institute™ of the nation's tax laws to be authoritative and of help to taxpayers. Every care has been taken in the preparation of the text to ensure its clarity and accuracy. Taxpayers are cautioned, however, that this book is sold with the understanding that the Publisher is not engaged in rendering legal, accounting, or other professional service. Taxpayers with specific tax problems are urged to seek the professional advice of a tax accountant, lawyer, or preparer.

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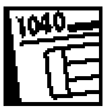
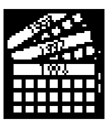
How To Use
Your Income Tax
1997

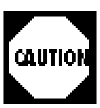
TAX ALERT SYMBOLS—Throughout the text of *Your Income Tax*, these special symbols alert you to advisory tips about filing your return and tax planning opportunities:



A FILING POINTER or FILING INSTRUCTION helps you prepare your 1996 return.



A PLANNING POINTER or PLANNING STRATEGY highlights year-end tax strategies for 1996 or planning opportunities for 1997 and later years.



A CAUTION points out potential pitfalls to avoid and areas where IRS opposition may be expected.

A LAW ALERT indicates recent changes in the tax law and pending legislation before Congress.

A COURT DECISION highlights key rulings from the Tax Court and other federal courts.

The federal income tax law, despite efforts of simplification, remains a maze of statutes, regulations, rulings, and court decisions written in technical language covering thousands and thousands of pages. For over 59 years, *J.K. Lasser's™ Your Income Tax* has aided and guided millions of taxpayers through this complex law. Every effort has been made to provide a direct and easy-to-understand explanation that shows how to comply with the law and at the same time take advantage of tax-saving options and plans.

The 1997 edition of Your Income Tax—our 60th edition—continues this tradition.

To make maximum use of this tax guide, we suggest that you use these aids:

OUTLINE OF PARTS—Page v shows the nine major parts of the book and directly leads you to each part through the color-coded index tab.

CHAPTER CONTENTS—The contents, on pages vii-xii list the chapters in *Your Income Tax*. Note that references with paragraph signs (¶) direct you to sections within a particular chapter. Thus a reference to ¶22.1 directs you to Chapter 22 and then to section 1 within that chapter. Section and page references are provided in the major index at the back of the book.

REFERENCE GUIDE TO FORM 1040 AND SCHEDULES A AND B—This guide, on pages xv-xviii, directs you from the lines on Form 1040 and Schedules A and B that you are interested in to the section in *Your Income Tax* that covers the topic.

WHAT'S NEW FOR 1996 TAX RETURNS— The *What's New* section, on page xxv, alerts you to key tax law developments and new tax legislation, IRS rulings, and court decisions that may affect your 1996 tax return or tax planning for 1997.

GLOSSARY OF TAX TERMS—The tax law is a technical subject with its own particular terminology. All of the major tax terms are defined in this special glossary starting on page xxviii–xxxii.

INCOME TAX BASICS—Pages 1–6 alert you to filing requirements, filing addresses shown on a map of IRS Service Centers, and a calendar with 1997 filing deadlines.

TAX ORGANIZER—This section, starting on page 615, is designed to help you get your data in order and to prepare your tax return.

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- Money-Market Investments; ¶32.1, ¶32.2
- Corporate Bond Investments; ¶30.16
- Tax Exempts; ¶¶4.24–4.26, ¶30.18, ¶32.6
- Mutual-Fund Distributions; ¶32.5
- Selling Mutual-Fund Shares; ¶32.9
- Deferring Interest on T-Bills and CDs; ¶4.29, ¶30.14

CAR OWNERS

- Deducting IRS Standard Mileage Allowance; ¶43.1
- Commuting Costs; ¶20.2
- Car Operating Expenses; ¶43.2
- Auto Depreciation Restrictions; ¶43.3, ¶43.5
- Trading in a Business Auto; ¶43.8
- Keeping Records of Business Travel; ¶43.10
- Leasing Business Auto; ¶43.11
- Casualty Loss for Damage to Car; ¶18.7

RETIREES

- Retiring on Social Security; ¶34.5
- When Extra Wage Income May Not Be Worth It; ¶34.6
- Figuring Taxable Portion of Social Security Benefits; ¶34.3
- Tax Credit for Disability; ¶34.7
- Claiming the $125,000 Exclusion After Age 55 for Residence Sale; ¶¶29.14–29.17
- Computing Minimum IRA Distributions After Age 70 1/2; ¶8.14
- Moving into Continuing Care Facility; ¶34.10,
- Tax-free Rollover from Employer Plan; ¶7.8
- Special Averaging for Lump-Sum Distributions; ¶7.2–¶7.4

SELF-EMPLOYED PERSONS

- New Business Opportunities; ¶40.10
- Accounting Method Options; ¶40.2
- Reporting Large Cash Receipts to IRS; ¶40.4
- Choosing a Taxable Year; ¶40.3
- Checklist of Professional Deductions; ¶40.6
- Deducting Home Office Costs; ¶¶40.11–40.16
- Keogh and SEP Retirement Plans; ¶¶41.1–41.5
- Self-Employment Tax Liability; ¶46.1
- Health Insurance Premium Deductions; ¶17.6, ¶40.5
- Hobby Loss Restrictions; ¶40.9
- Schedule C Filing; ¶40.5

EMPLOYEES

- Reporting Year-End Checks; ¶2.2
- Deferring Tax on Pay; ¶2.8
- Company Plan Coverage Affects IRA; ¶8.4
- When Workers' Compensation is Tax Free; ¶2.12
- Tax-Free Health Coverage and Plan Payments; ¶3.1
- Company Cars, Parking and Transit Passes; ¶3.5
- When Employer's Education Assistance Is Tax free; ¶3.6
- Deductible Education Costs; ¶19.15
- 401(k) Plan Salary Deferrals; ¶7.17
- Deducting Job Search Costs; ¶19.7
- Reimbursed Travel and Entertainment Costs; ¶20.30

ARMED FORCES PERSONNEL

- Checklist of Tax-Free Benefits; ¶35.2
- Deducible Travel Costs; ¶35.3
- Tax-Free Combat or Hazardous Duty Area Pay; ¶35.4
- Getting Extensions to File; ¶35.7
- Tax Data for Reservists; ¶35.8
- Deductions for Moving Expenses; ¶35.3
- Military Disability Provisions; ¶2.13
- Deferring Home Sale Gain; ¶29.4
- Uniform Costs; ¶35.3
- Where to File; ¶35.1

MEDICAL CARE

- Away-From-Home Trips to Get Medical Care; ¶17.9
- Deducting Wages for Nurses' Services; ¶17.12
- Deducting Costs of Senior Citizen Care Facility; ¶17.11
- Deducting Cost of a Home Spa; ¶17.13
- Deducting Medical Care Premiums; ¶17.6
- Driving to Doctor or Hospital; ¶17.9
- Deducting Dependents' Medical Expenses; ¶17.7
- Long-Term Care Costs; ¶17.15
- Medical Savings Accounts (MSAs); ¶17.16

COMPUTER OWNERS

- When Expensing or Accelerated Depreciation is Allowed; ¶42.10
- Mandatory Straight-Line Depreciation; ¶42.9-¶42.10
- Recapture of Prior Depreciation Deductions; ¶42.10
- Employee Deduction Restrictions; ¶19.9
- Calculators, Faxes and Copiers; ¶19.10
- Using Computer to Manage Investments; ¶42.10

1040 Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return 1996 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 1996, or other tax year beginning , 1996, ending , 19 | OMB No. 1545-0074

Label (See instructions.)
Use the IRS label. Otherwise, please print or type.

Your first name and initial | Last name | Your social security number
If a joint return, spouse's first name and initial | Last name | Spouse's social security number
Home address (number and street). If you have a P.O. box, see page 11. | Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, see page 11.

For help finding line instructions, see pages 2 and 3 in the booklet.

Presidential Election Campaign (See page 11.)
Do you want $3 to go to this fund? | Yes | No
If a joint return, does your spouse want $3 to go to this fund?
Note: Checking "Yes" will not change your tax or reduce your refund.

See ¶

Filing Status (Check only one box.)

		See ¶
1	Single	—¶1.1
2	Married filing joint return (even if only one had income)	—¶1.3
3	Married filing separate return. Enter spouse's social security no. above and full name here. ►	—¶1.2
4	Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ►	—¶1.10
5	Qualifying widow(er) with dependent child (year spouse died ► 19). (See instructions.)	—¶1.6

Exemptions

		See ¶
6a	Yourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a.	—¶22.1
b	Spouse	—¶22.2
c	Dependents: (1) First name, Last name; (2) Dependent's social security number. If born in Dec. 1996, see inst.; (3) Dependent's relationship to you; (4) No. of months lived in your home in 1996	—¶22.1
	No. of boxes checked on lines 6a and 6b; No. of your children on line 6c who: • lived with you • didn't live with you due to divorce or separation (see instructions); Dependents on 6c not entered above	—¶22.11
d	Total number of exemptions claimed. Add numbers entered on lines above ►	—¶22.1

If more than six dependents, see the line 6c instructions.

Income

Attach Copy B of your Forms W-2, W-2G, and 1099-R here.
If you did not get a W-2, see the line 7 instructions.
Please send any payment separately with Form 1040-V. See the line 12a instructions.

		See ¶
7	Wages, salaries, tips, etc. Attach Form(s) W-2	—¶2.1
8a	Taxable interest. Attach Schedule B if over $400	—¶4.12
b	Tax-exempt interest. DON'T include on line 8a (8b)	—¶4.24 & ¶4.26
9	Dividend income. Attach Schedule B if over $400	—¶4.1
10	Taxable refunds, credits, or offsets of state and local income taxes (see instructions)	—¶12.7
11	Alimony received	—¶37.1
12	Business income or (loss). Attach Schedule C or C-EZ	—¶40.1 & ¶40.5
13	Capital gain or (loss). If required, attach Schedule D	—¶5.2 &¶32.5
14	Other gains or (losses). Attach Form 4797	—¶44.1
15a	Total IRA distributions (15a); b Taxable amount (see inst.) (15b)	—¶8.8
16a	Total pensions and annuities (16a); b Taxable amount (see inst.) (16b)	—¶7.22 &¶7.25
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	—¶9.1
18	Farm income or (loss). Attach Schedule F	—¶45.16
19	Unemployment compensation	—¶2.6
20a	Social security benefits (20a); b Taxable amount (see inst.) (20b)	—¶34.2 &¶34.3
21	Other income. List type and amount—see instructions	— Chapter 12
22	Add the amounts in the far right column for lines 7 through 21. This is your **total income** ►	

Adjusted Gross Income

If line 31 is under $28,495 (under $9,500 if a child didn't live with you), see the line 54 instructions.

		See ¶
23a	Your IRA deduction (see instructions)	—¶8.4
b	Spouse's IRA deduction (see instructions)	—¶8.3 & ¶8.4
24	Moving expenses. Attach Form 3903 or 3903-F	—Chapter 21
25	One-half of self-employment tax. Attach Schedule SE	—¶46.3
26	Self-employed health insurance deduction (see inst.)	—¶17.6 & ¶40.1
27	Keogh & self-employed SEP plans. If SEP, check ► ☐	—¶8.16 & ¶41.5
28	Penalty on early withdrawal of savings	—¶4.16
29	Alimony paid. Recipient's SSN ►	—¶37.1
30	Add lines 23a through 29	
31	Subtract line 30 from line 22. This is your **adjusted gross income** ►	—¶13.7

For Privacy Act and Paperwork Reduction Act Notice, see page 7. Cat. No. 11320B Form **1040** (1996)

See ¶

Form 1040 (1996) Page 2

Tax Computation

32 Amount from line 31 (adjusted gross income) — 32 — ¶13.7

33a Check if: ☐ You were 65 or older, ☐ Blind; ☐ Spouse was 65 or older, ☐ Blind. Add the number of boxes checked above and enter the total here ▶ 33a — ¶13.4

b If you are married filing separately and your spouse itemizes deductions or you are a dual-status alien, see instructions and check here ▶ 33b ☐ — ¶13.3

34 Enter the larger of your:
- **Itemized deductions** from Schedule A, line 28, OR — ¶13.1
- **Standard deduction** shown below for your filing status. But see the instructions if you checked any box on line 33a or b or someone can claim you as a dependent. — ¶13.2
  - Single—$4,000
  - Married filing jointly or Qualifying widow(er)—$6,700
  - Head of household—$5,900
  - Married filing separately—$3,350

— ¶13.6 — 34

35 Subtract line 34 from line 32 — 35

36 If line 32 is $88,475 or less, multiply $2,550 by the total number of exemptions claimed on line 6d. If line 32 is over $88,475, see the worksheet in the inst. for the amount to enter — 36 — ¶22.15

If you want the IRS to figure your tax, see the line 37 instructions.

37 **Taxable income.** Subtract line 36 from line 35. If line 36 is more than line 35, enter -0- — 37

38 **Tax.** See instructions. Check if total includes any tax from a ☐ Form(s) 8814 b ☐ Form 4970 c ☐ Form 4972 ▶ 38 — Chapters 23 & 24, ¶11.3 & ¶7.4

Credits

39 Credit for child and dependent care expenses. Attach Form 2441 — 39 — ¶25.1

40 Credit for the elderly or the disabled. Attach Schedule R — 40 — ¶34.7

41 Foreign tax credit. Attach Form 1116 — 41 — ¶36.14

42 Other. Check if from a ☐ Form 3800 b ☐ Form 8396 c ☐ Form 8801 d ☐ Form (specify) — 42 — ¶15.1 & ¶23.9, ¶ 40.22

43 Add lines 39 through 42 — 43

44 Subtract line 43 from line 38. If line 43 is more than line 38, enter -0- ▶ 44

Other Taxes

45 Self-employment tax. Attach Schedule SE — 45 — Chapter 46

46 Alternative minimum tax. Attach Form 6251 — 46 — ¶23.3

47 Social security and Medicare tax on tip income not reported to employer. Attach Form 4137 — 47 — ¶26.8

48 Tax on qualified retirement plans, including IRAs. If required, attach Form 5329 — 48 — ¶8.7, ¶8.12, ¶8.13

49 Advance earned income credit payments from Form W-2 — 49 — ¶25.13

50 Household employment taxes. Attach Schedule H — 50 — ¶25.7

51 Add lines 44 through 50. This is your **total tax** ▶ 51

Payments

52 Federal income tax withheld from Forms W-2 and 1099 — 52 — ¶26.1

53 1996 estimated tax payments and amount applied from 1995 return — 53 — ¶27.1

54 **Earned income credit.** Attach Schedule EIC if you have a qualifying child. Nontaxable earned income: amount ▶ and type ▶ — 54 — ¶25.10

Attach Forms W-2, W-2G, and 1099-R on the front.

55 Amount paid with Form 4868 (extension request) — 55 — Part VIII

56 Excess social security and RRTA tax withheld (see inst.) — 56 — ¶26.10

57 Other payments. Check if from a ☐ Form 2439 b ☐ Form 4136 — 57 — ¶32.8 & ¶40.23

58 Add lines 52 through 57. These are your **total payments** ▶ 58

Refund

59 If line 58 is more than line 51, subtract line 51 from line 58. This is the amount you OVERPAID — 59

60a Amount of line 59 you want **REFUNDED TO YOU** ▶ 60a

Have it directly deposited! See inst. and fill in 60b, c, and d.

b Routing number — c Type: ☐ Checking ☐ Savings

d Account number

61 Amount of line 59 you want **APPLIED TO YOUR 1997 ESTIMATED TAX** ▶ 61

Amount You Owe

62a If line 51 is more than line 58, subtract line 58 from line 51. This is the **AMOUNT YOU OWE.** For details on how to pay and use **Form 1040-V**, see instructions ▶ 62a

b Are you paying the amount on line 62a **in full** with Form 1040-V? ▶ ☐ Yes ☐ No

63 Estimated tax penalty. Also include on line 62a — 63 — ¶27.5

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Keep a copy of this return for your records.

▶ Your signature — Date — Your occupation

▶ Spouse's signature. If a joint return, BOTH must sign. — Date — Spouse's occupation — ¶1.3

Paid Preparer's Use Only

Preparer's signature ▶ — Date — Check if self-employed ☐ — Preparer's social security no.

Firm's name (or yours if self-employed) and address ▶ — EIN — ZIP code

SCHEDULES A&B (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Schedule A—Itemized Deductions

(Schedule B is on back)

► Attach to Form 1040. ► See Instructions for Schedules A and B (Form 1040).

OMB No. 1545-0074

1996

Attachment Sequence No. **07**

Name(s) shown on Form 1040 | Your social security number

			See ¶
Medical and Dental Expenses		Caution: *Do not include expenses reimbursed or paid by others.*	
	1	Medical and dental expenses (see page A-1) 1	—¶17.2
	2	Enter amount from Form 1040, line 32. 2	
	3	Multiply line 2 above by 7.5% (.075) 3	—¶17.4
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0- 4	
Taxes You Paid (See page A-1.)	5	State and local income taxes 5	—¶16.3
	6	Real estate taxes (see page A-2) 6	—¶16.6
	7	Personal property taxes 7	—¶16.1
	8	Other taxes. List type and amount ► 8	—¶16.1
	9	Add lines 5 through 8 9	
Interest You Paid (See page A-2.)	10	Home mortgage interest and points reported to you on Form 1098 10	—¶15.1
	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address ► 11	—¶15.1
Note: Personal interest is not deductible.	12	Points not reported to you on Form 1098. See page A-3 for special rules 12	—¶15.8
	13	Investment interest. If required, attach Form 4952. (See page A-3.) 13	—¶15.10
	14	Add lines 10 through 13 14	
Gifts to Charity	15	Gifts by cash or check. If you made any gift of $250 or more, see page A-3 15	—¶14.1 & ¶14.15
If you made a gift and got a benefit for it, see page A-3.	16	Other than by cash or check. If any gift of $250 or more, see page A-3. If over $500, you **MUST** attach Form 8283 16	—¶14.1,¶14.12, & ¶14.15
	17	Carryover from prior year 17	
	18	Add lines 15 through 17 18	
Casualty and Theft Losses	19	Casualty or theft loss(es). Attach Form 4684. (See page A-4.) 19	—¶18.12
Job Expenses and Most Other Miscellaneous Deductions	20	Unreimbursed employee expenses—job travel, union dues, job education, etc. If required, you **MUST** attach Form 2106 or 2106-EZ. (See page A-5.) ► 20	—¶19.1 & ¶19.3
	21	Tax preparation fees 21	—¶19.25
(See page A-5 for expenses to deduct here.)	22	Other expenses—investment, safe deposit box, etc. List type and amount ► 22	—¶19.24
	23	Add lines 20 through 22 23	
	24	Enter amount from Form 1040, line 32. 24	
	25	Multiply line 24 above by 2% (.02) 25	
	26	Subtract line 25 from line 23. If line 25 is more than line 23, enter -0- 26	
Other Miscellaneous Deductions	27	Other—from list on page A-5. List type and amount ► 27	—¶19.1
Total Itemized Deductions	28	Is Form 1040, line 32, over $117,950 (over $58,975 if married filing separately)? **NO.** Your deduction is not limited. Add the amounts in the far right column for lines 4 through 27. Also, enter on Form 1040, line 34, the **larger** of this amount or your standard deduction. **YES.** Your deduction may be limited. See page A-5 for the amount to enter. ► 28	—¶13.8

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11330X Schedule A (Form 1040) 1996

Schedules A&B (Form 1040) 1996 OMB No. 1545-0074 Page 2

Name(s) shown on Form 1040. Do not enter name and social security number if shown on other side. **Your social security number**

Schedule B—Interest and Dividend Income

Attachment Sequence No. 08

See ¶

Part I Interest Income

(See page B-1.)

Note: *If you had over $400 in taxable interest income, you must also complete Part III.*

1 List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see page B-1 and list this interest first. Also, show that buyer's social security number and address ▶ — ¶4.12

Note: If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

		Amount
1 List name of payer …	1	
2 Add the amounts on line 1	2	
3 Excludable interest on series EE U.S. savings bonds issued after 1989 from Form 8815, line 14. You MUST attach Form 8815 to Form 1040	3	
4 Subtract line 3 from line 2. Enter the result here and on Form 1040, line 8a ▶	4	

—¶33.3

Part II Dividend Income

(See page B-1.)

Note: *If you had over $400 in gross dividends and/or other distributions on stock, you must also complete Part III.*

5 List name of payer. Include gross dividends and/or other distributions on stock here. Any capital gain distributions and nontaxable distributions will be deducted on lines 7 and 8 ▶ —¶4.1, ¶4.3, & ¶32.5

Note: If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total dividends shown on that form.

			Amount
5 List name of payer …		5	
6 Add the amounts on line 5		6	
7 Capital gain distributions. Enter here and on Schedule D*	7		
8 Nontaxable distributions. (See the inst. for Form 1040, line 9.)	8		
9 Add lines 7 and 8		9	
10 Subtract line 9 from line 6. Enter the result here and on Form 1040, line 9 ▶		10	

—¶4.3 & ¶32.5

—¶4.3, ¶4.11, & ¶32.5

**If you do not need Schedule D to report any other gains or losses, see the instructions for Form 1040, line 13.*

Part III Foreign Accounts and Trusts

(See page B-2.)

If you had over $400 of interest or dividends **or** had a foreign account or were a grantor of, or a transferor to, a foreign trust, you must complete this part.

	Yes	No
11a At any time during 1996, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See page B-2 for exceptions and filing requirements for Form TD F 90-22.1		
b If "Yes," enter the name of the foreign country ▶		
12 Were you the grantor of, or transferor to, a foreign trust that existed during 1996, whether or not you have any beneficial interest in it? If "Yes," you may have to file Form 3520, 3520-A, or 926		

—¶36.13

For Paperwork Reduction Act Notice, see Form 1040 instructions. Schedule B (Form 1040) 1996

WHAT YOU MAY EXCLUDE FROM GROSS INCOME

Alimony, which does not meet rules of Chapter 37
Annuity payments that repay your cost; ¶7.22
Armed Forces benefits and pay; ¶35.2, ¶35.4
Armed Forces disability pensions; ¶35.2

Borrowed money returned to you; ¶2.9

Casualty insurance and other reimbursement losses not exceeding basis of property; ¶18.15
Child support; ¶37.5
Clergymen's rental or parsonage allowances; ¶3.12
Combat or hazardous duty area pay; ¶35.4

Damages resulting from suit for following: Injury to good will or loss of capital, libel, loss of life, personal injuries, slander, certain discrimination awards; ¶12.10, ¶12.11
Death benefits of up to $5,000 received before August 20, 1996; ¶3.4, ¶7.28
Dependent care assistance from qualified employer plan, within limits; ¶3.7
Dividends on life insurance policies until net premiums you paid for the contract are recovered; ¶4.11

Education assistance under employer plans; ¶3.6
Employer contributions to a qualified pension plan for employee's benefit, within limits; ¶7.25
Employer contributions to tax-sheltered annuities for employee's benefit, within limits; ¶7.25
Employer furnished meals or lodging for the convenience of the employer; ¶3.11
Employer paid business subscriptions or reimbursed membership dues in professional associations; ¶3.8

Flexible spending arrangement reimbursements, subject to certain limits; ¶3.14
Foreign earned income up to $70,000; ¶36.2
Forgiven debts that meet tax exclusion rules; ¶12.9
Free or low-cost company services or products; ¶3.15

Gifts;¶11.1
Government disability pensions; ¶2.13
Group-term life insurance premiums paid by employer for coverage up to $50,000; ¶3.3

Health and accident coverage under employer plans; ¶3.1
Home sale profit of up to $125,000 by owner 55 or over; ¶¶29.14–29.17

Improvements by lessees; ¶42.15
Inherited money or property; ¶11.1
Interest credited on frozen deposits; ¶4.13
Interest on Series EE bonds issued after 1989 if used for tuition and income tests met; ¶33.3
Interest earned on qualified employer retirement plans or IRA's until withdrawal; ¶7.17, ¶8.1
Interest received on tax-exempt government bonds; ¶4.24
IRA distributions timely rolled over to another IRA; ¶8.10

Job placement assistance, subject to certain limitations; ¶3.8

Life insurance received because of the death of the insured; ¶11.5
Like-kind exchanges of investment property; ¶6.1
Liquidating distributions that are a return of capital; ¶44.12

Moving expense reimbursements under accountable plan; ¶21.6
Mileage allowance from employer up to IRS limit; ¶20.33, ¶43.1

Overtime meal money and cab fare; ¶3.9

Pre-tax salary deferrals to 401(k) or other qualified retirement plans, within limits; ¶7.18

Refund of state or local tax for year you claimed standard deduction; ¶12.7
Reimbursed business travel and entertainment expenses under accountable plan; ¶20.30
Reimbursed medical expenses for permanent physical injury from qualifying employer plan; ¶3.2
Rollovers from one qualified employer retirement plan to another, or to an IRA; ¶7.8, ¶8.10

Scholarship awards covering degree candidate's tuition and related fees; ¶¶12.4–12.6
Social Security benefits, if under base amount; ¶34.3
Stock dividends and stock options; ¶4.6

Vanpool, transit pass or employer-provided parking, within limits; ¶3.5

Worker's Compensation benefits; ¶2.12

WHAT YOU MAY DEDUCT

Alimony paid under the rules of Chapter 37
Amortized bond premium; ¶4.17
Appraisal costs for donated property; ¶14.12

Bad debts subject to limits for nonbusiness loans; ¶5.9
Bank deposit loss in insolvent bank; ¶5.7, ¶18.4
Burglary losses; ¶18.8
Business expenses; ¶¶40.5–40.10
Business gifts up to $25; ¶2.4, ¶20.25
Business use or rental of a car; ¶19.12

Capital loss within limits; ¶5.17
Casualty losses within limits; Chapter 18
Charges for services on rental property, e.g., water, sewer, trash; ¶9.2
Charitable contributions; Chapter 14
Christmas presents and other holiday gifts to employees, clients, or customers up to $25 a person; ¶2.4
Clothing, uniforms, costumes, laundering, and cleaning; ¶19.6
Condominium owner's interest and real estate taxes; ¶15.9
Convention (business or professional) expenses; ¶20.12

Depletion of oil and gas wells, other natural deposits, and timber; ¶9.14, ¶9.15
Depreciation of home computers or cellular telephones, subject to restrictions; ¶19.9
Depreciation of leasehold improvements; ¶42.15
Depreciation of rental building; ¶9.2,¶42.13
Depreciation of rental property furniture and appliances; ¶9.2
Disaster losses; ¶18.2

Education—cost of tuition, books, if required to keep your job or improve job or professional skills; ¶19.16
Embezzlement losses; ¶18.8
Employment agency fees; ¶ 19.7

Foreign housing costs if self-employed within limits; ¶36.3
Foreign income tax and property taxes; ¶16.12

Gambling losses to extent of gambling gains; ¶12.3

Half of self-employment tax liability; ¶46.3
Health care insurance premiums; ¶17.6
Home mortgage interest; ¶15.1

Impairment-related work expenses; ¶19.4
Income tax return preparation fees; ¶19.25
Individual retirement account (IRA) contributions, within limits; ¶8.2–¶8.4
Investment interest within limits; ¶15.10

Job-search expenses; ¶19.7

Keogh plan contributions within limits; ¶41.5

Legal expenses; ¶19.26
Long-term care insurance and services; ¶17.15
Losses on small business stock; ¶5.3, ¶30.20

Magazine subscriptions used for business or professional purposes; ¶19.5
Malpractice insurance; ¶40.5, ¶40.6
Medical and dental expenses within limits; ¶ 17.1
Medical savings accounts (MSAs); ¶17.16
Moving expenses to new job location; Chapter 21

Nurses' wages; ¶17.12

Points paid on purchase or improvement of principal residence; ¶15.8

Real estate taxes; ¶16.6
Rent for business property; ¶9.1
Repairs of business or income-producing property; ¶9.3

Schooling costs for a mentally or physically handicapped dependent; ¶17.10
Simplified Employee Pension (SEP) contributions, within limits; ¶8.16, ¶8.17
Standard deduction; Chapter 13
State and local income taxes; ¶16.2
State and local personal property tax; ¶16.3

Taxes that are business expenses; ¶16.11
Tools used on your job having a life of less than a year; ¶19.11
Travel expenses necessary to maintain property; ¶9.2
Travel costs to take education courses; ¶19.23
Travel costs to get medical care; ¶17.9

Work clothes and uniforms; ¶19.6
Worthless securities; ¶5.7

FREQUENTLY ASKED QUESTIONS

Q. How can I check on the status of my refund?

A. Call the IRS Tele-tax number to get automated refund information. *See* page 619 for the number for your area.

Q. I just completed my return and find that I owe the IRS money that I cannot pay. What should I do?

A. You should file your return even if you cannot pay all of the amount owed. File by April 15, 1997, and pay as much as possible. By filing on time, you avoid the late filing penalty. By paying as much of the amount as possible, you reduce the amount of interest and late payment penalty you will owe. *See* page 618.

Q. Can I ask to make installment payments on the amount I owe on any 1996 return?

A. Yes. You may request an installment arrangement on Form 9465. However, you will be charged interest and possibly a late payment penalty on the tax not paid by April 15, 1997, even if your request to pay in installments is granted. *See* page 618.

Q. If I am unable to finish my return by April 15, 1997, how can I get an extension?

A. You can get a four-month extension by filing Form 4868 by April 15, 1997. By filing for the extension, you avoid the late filing penalty. However, Form 4868 does not extend the time to pay your income tax. You will have to pay interest, and possibly late payment penalties. *See* page 617.

Q. What can I do to make sure I will not owe the IRS tax on my 1997 return?

A. You can either increase the amount of income tax withheld from your pay or make estimated tax payments to meet your 1997 tax liability. *See* ¶27.1.

Q. How can I get forms and publications?

A. Call 1-800-TAX -FORM (1-800-829-3676) or visit your local IRS office. A local library, bank, or post office may have tax forms. Forms may also be obtained by using a computer modem to access Fedworld, an IRS information service. *See* the IRS site on the world wide web located at *http://www.irs.ustreas.gov* or direct dial by modem at (703) 321-8020.

Q. If my father has Social Security benefits over $2,550, can I claim him as my dependent?

A. Yes, if the Social Security is not taxable under the rules of ¶34.3. Dependents other than certain children must have *gross income* of less than $2,550, but gross income does *not* include nontaxed items such as gifts, tax-exempt interest, or nontaxable Social Security. *See* ¶22.3.

Q. My aunt was solely dependent on me for years. Last spring she died. Can I claim an exemption for her in 1996?

A.Yes. You get the full exemption of $2,550 for the year even though she lived only a few months in 1996. The same rule applies to dependents born during the year. For example, if your child was born in late December you may claim a full $2,550 exemption for the child. *See* ¶13.5, ¶22.3.

Q. I supported my father for only three months during 1996; my brother took care of him the rest of the time. But I contributed more than 50% of his support. Who may claim the exemption?

A.You do. The test is not the “time” of support but the value of the support. You get the exemption because you furnished more than half of his support during the whole year. *See* ¶22.3, ¶22.7.

Q. My sister and I have been taking care of our parents. We split the support 50-50. Who may claim the exemption?

A. If you and another support the same person, the one furnishing more than half of the support is entitled to the credit. Here you and your sister furnish equal support. You may decide between yourselves who is to claim the exemption. The one who claims the exemption must attach Form 2120, the Multiple Support Agreement, to his or her return. *See* ¶22.7, ¶22.10.

Q. I am paid on a percentage of my sales. But I got an advance on my next year’s pay. Is that taxed?

A.Yes, if it is an unrestricted advance, one where you can keep the money. If your employer does not have a policy of demanding repayment for unearned commissions, the advance is taxable. However, if it is really a loan which you must repay if you do not earn the amount, it is not taxed. *See* ¶2.1, ¶2.5.

Q. I bought some stock on the dividend record date. The corporation declared a dividend to holders of record on July 17, 1996, and I bought the stock that same day. Do I pay a tax on this?

A. No. You do not include the dividend on your return. The dividend is paid to the seller of the stock, who must report it as income. *See* ¶4.9.

Q. I hear that some stock dividends are not taxed. How can I tell which I can exclude from my tax return?

A. Keep the dividend statements and other literature accompanying your distributions. They usually tell you exactly how to treat dividends on your return. *See* ¶4.8.

Q. My father died last year and I received $100,000 as the beneficiary under his insurance policy. Do I report the payment?

A. No. Life insurance payments are not subject to income tax. *See* ¶11.5.

Q. I received $10,000 under my uncle's will. Is that taxed?

A. No. Inheritances are exempt from tax. But any income (say, the interest you earn) from this property *after you receive it* is taxed. *See* ¶11.1.

Q. I sold my old house at a $50,000 profit but I'm not buying a new house. I'm building one. Does the tax law distinguish between building and purchasing a new house for purposes of deferring tax?

A. No. The rules are the same for buying or building a replacement residence. You must complete construction and move into the new house before the end of the two-year replacement period. *See* ¶29.2, ¶29.4.

Q. I sold my principal residence at a loss. Can I deduct that loss on my return?

A. No. You cannot. Loss deductions are not allowed for *personal-use* property. However, there are moves in Congress to allow a loss deduction on sales of principal residences. *See* ¶29.11.

Q. My son worked in my shop during the summer. I paid him $2,100 and withheld taxes from his wages. May I deduct the wages and still claim an exemption for him as my dependent?

A. If you paid your son reasonable wages you may deduct what you paid him as a business expense. Since your son's wages were under $2,550 you may claim him as your dependent, assuming you provide most of his support. If at the end of the year he was under age 19 or a full-time student under age 24, he could be your dependent even if his income were $2,550 or more. He should also file a separate tax return to get a refund of the taxes withheld from his pay. *See* ¶1.11, ¶22.6.

Q. How can I make certain that a scientific organization to which I am planning to donate some money is qualified to receive deductible donations?

A. Ask organization officials for proof of their qualified status, or check IRS Publication 78, which lists most qualified organizations. *See* ¶14.1.

Q. May I deduct my unreimbursed costs for gasoline and oil while doing work for a charitable organization?

A. Yes. The expenses are deductible if you claim itemized deductions on your return. You may deduct a flat 12-cents-a-mile if that is greater. Do not forget to deduct expenses for uniforms required for your charity work. *See* ¶14.1, ¶14.4.

Q. Do I need to get a receipt from a charity for a cash donation?

A. Yes, if you gave $250 or more. If you gave under $250, your cancelled check is acceptable substantiation; a receipt is optional. For donations of $250 or more, get the receipt by the time you file. The charity should include in the receipt an estimate of the value of any benefits you received. *See* ¶14.15.

Q. In 1996, I paid state taxes for two taxable years. I prepaid my 1996 state income tax before the end of 1996, and I previously paid my 1995 state tax in 1996. Can I deduct both?

A. Yes. Your payment of the 1996 income tax before it was due does not affect your right to deduct the amount, provided the state accepts it as a tax payment and it is a reasonable approximation of what you owe. *See* ¶16.3.

Q. My personal camera and video equipment were stolen from my apartment. I do not know who did it. Can I deduct the loss?

A. A theft loss may be claimed as an itemized deduction, but as a practical matter the deduction may not be allowed because it does not exceed 10% of your adjusted gross income. Even if it exceeded this and the $100 floor, the IRS could disallow the loss if you are audited and argue that there is no proof of a theft. If there were witnesses to a break-in, see if you can get their statements. Reporting a theft to the police or offering a reward does not prove a theft occurred, but having a police record that there was a robbery would help you support the deduction. *See* ¶18.8.

Q. Can I get a bad debt loss for a salary which I earned but was not paid?

A. No. If you are on the cash basis (and most individuals are), you cannot get the deduction for unpaid salary, rent, or fees. On the cash basis you do not include salary as income until you are paid. Merely being entitled to payment but not receiving it does not entitle you to a deduction. *See* ¶2.2.

Q. I loaned money to my sister-in-law. She has not paid back the loan. Can I claim a bad debt loss?

A. Yes, if there was an enforceable promise to repay at the time the debt was created and you can show that she became financially unable to pay in 1996. The deduction would be claimed as a short-term capital loss. If the advance you made was really a gift and you did not expect to be repaid, you may not take a deduction. *See* ¶5.12.

Q. Can I make a deductible contribution to an IRA if I contribute to a 401 (k) plan at work?

A. It depends on your income. For active plan participants, IRA deductions are phased out over a modified adjusted gross income range of $25,000–$35,000 for single persons, or $40,000–$50,000 for married persons filing jointly. *See* ¶8.4.

Q. Can I take an IRA deduction for the amount I contributed to a 401(k) plan in 1996?

A. No. A 401(k) plan is not an IRA. However, the amount contributed is not included as income in Box 1 of your W-2 Form, so you don't pay tax on it this year. *See* ¶7.17.

Q. What is "itemizing"? How can it help me?

A. You should itemize if you have deductible expenses that exceed your standard deductions. You itemize deductions by filing Schedule A with Form 1040. On Schedule A, you list amounts you paid during the year for items such as medical and dental care, state and local income taxes, real estate taxes, home mortgage interest, casualty losses, gifts to charity and miscellaneous job costs, investment expenses and tax preparation fees. *See* ¶13.2.

Q. I refinanced my home in 1996 and paid "points". Can I deduct the entire amount as interest on my 1996 return?

A. No. Points paid solely to refinance your home may not be deducted in the year paid. Instead, they must be deducted over the life of the loan. *See* ¶15.8.

Q. What are the deductible mileage rates for 1996?

A. The rate for business travel is 31 cents per mile. The rate for travel for medical care and moving expenses is 10 cents per mile. The rate for travel for deductible volunteer work is 12 cents per mile. *See* ¶14.4, ¶17.9, ¶20.33, ¶21.1, ¶43.1.

Q. I withheld Social Security taxes from the wages of a person who cares for my child while I work. How do I report the withheld taxes?

A. You report the withholdings, as well as your own employer's share of Social Security and Medicare taxes, on new Schedule H. You pay the taxes when you file your personal 1996 return. *See* ¶25.8.

30 CHECKPOINTS BEFORE FILING

1. Check that you have filed the correct tax returns. Use Form l040EZ or Form 1040A only if it will save you time and not cause you to give up tax-savings deductions or credits that can only be claimed on Form 1040.

2. Check your arithmetic.

3. Check that you have indicated the correct filing status. If you are married, review whether filing separately would save you more than filing jointly. If you are single and support a dependent, check whether you may claim head of household status.

4. Check that your Social Security number is written correctly, and the number is written on all schedules and statements attached to your return.

5. Check the amount of your itemized deductions against the standard deduction allowed for your filing status. Claim the larger deduction. Check that you have claimed the additional standard deduction allowed if you are age 65 or over, or blind.

6. Check that all tax withholdings are entered on your return so they can be credited against your tax liabilities.

7. Check when using the tax tables that the tax taken is from the line and column applicable to your filing status.

8. Check that a refund amount shown on your return is correct and indicate whether you want the refund in cash or credited to your first estimated tax installment payment for 1997.

9. Check that the amount of tax liability indicated on your return and the amount written on your check or money order is the same. Also, your check or money order should include your Social Security number and note that it is in payment of your 1996 tax liability.

10. Check that all the necessary schedules and statements are attached to your tax return. Make two copies of the return, one for your own records and one for the state income tax authorities.

11. Check that you have signed the return. If you are filing jointly, check that your spouse has also signed.

12. Check that in calculating the amount of taxable Social Security benefits you use the base amounts applicable to your filing status.

13. Check whether you are entitled to a tax credit for excess FICA taxes withheld on your wages if you worked for more than one employer.

14. Check whether you are liable for Alternative Minimum Tax (AMT), especially if you have substantial itemized deductions.

15. Check whether you received a refund of state income taxes and correctly determined how much of the refund is taxable as a recovery of a tax benefit.

16. Check passive loss restrictions if you have income or losses from real estate investments.

17. Check that your withdrawals from IRAs and employer retirement accounts meet the minimum distribution requirements if you are age 70 1/2 or over.

18. Check the amount you contributed to your IRA against income limits that may reduce or eliminate your deduction if you are covered by an employer retirement plan.

19. Check if you are self-employed, that you have figured your self-employment tax, claimed a deduction for 50% of the tax, and claimed a deduction for Keogh or SEP plan contributions.

20. Check that you have attached all your withholding tax statements. Also check whether the statements are accurate. If not, ask your employer or other payer for a corrected copy.

21. Check whether you must begin to make estimated tax installments or whether your rate of withholding is in line with your estimated tax for 1997.

22. Check that you have claimed all deductible interest expenses. If you have been claiming amortizable points in prior years, include the amount deductible this year. If the mortgage ended early, deduct the balance of amortizable points this year.

23. Check that you have used the correct cost basis for sales of property bought in prior years.

24. Check that you have not reported tax-exempt interest as taxable interest.

25. Check your deductible auto expenses against the IRS allowance. Claim the larger amount.

26. Check that your Forms 1099 are accurate. If the forms are inaccurate ask the payer to prepare corrected forms.

27. Check if you are entitled to the tax credit for child and dependent care, that you prepare Form 2441 if filing a Form 1040, or Schedule 1, if filing a Form 1040A and attach the additional forms to the return.

28. Check that all documentary evidence including power of attorney or court certificate of legal representative is attached to a return not signed by the taxpayer.

29. Check if deducting alimony that the name and Social Security number of your former spouse is reported on Line 29, Form 1040.

30. Check if filing for a deceased taxpayer, that the date of death of the deceased is on the return.

WHAT'S NEW
NEW TAX LAW & DEVELOPMENTS

For further developments, please *see* our Supplement or visit us on line
@ *http://www.mcp.com/mgr/lasser/yit97/*

Accelerated death benefits. Tax-free treatment applies to accelerated death benefits received after 1996 from a life insurance contract by a terminally ill insured (certified as being expected to die within 24 months) and also to the proceeds of a life insurance contract sold or assigned to a viatical settlement company. Accelerated death benefits paid to a chronically ill person under a long-term care rider are tax free, up to a maximum of $175 per day for *per diem* policies. *See* ¶11.9.

Adoption credit. If you adopt a child under 18, or who is incapable of self-care, or has special needs, you may claim a tax credit of up to $5,000 of qualified adoption expenses for each eligible adoptee ($6,000 for each special needs adoptee) beginning in 1997. *See* ¶25.14.

Annual IRS notice of delinquency. Because of limited resources, the IRS has been slow to collect small delinquent accounts. After 1996, it must send annual reminders to taxpayers with outstanding delinquent accounts. *See* ¶48.8.

Attorneys' fees. For proceedings begun after July 30, 1996, the basic statutory limit on recoverable attorneys' fees by a prevailing taxpayer has been increased to $110 per hour. *See* ¶48.7.

Basis of retirement annuities. For annuity starting dates of November 19, 1996, or later, the portion of each annuity payment that represents a return of basis is equal to the employee's total investment in the contract, divided by the number of anticipated payments under a table covering five age ranges. This approach follows the current IRS optional simplified method. *See* ¶7.26.

Business credits. A Work Opportunity Credit applies to wages paid to employees in targeted categories who begin work on or after October 1, 1996, and before October 1, 1997. The credit percentage is 35% of up to $6,000 of each worker's first-year wages for a maximum credit of $2,100. For summer youth employees, the maximum credit is 35% of up to $3,000 of wages paid during a 90-day period, for a maximum credit of $1,050.

The 20% tax credit for increased research expenditures, which expired June 30, 1995, is reinstated, with certain modifications, for qualified expenditures from July 1, 1996, to May 31, 1997. See ¶40.22.

Business or investment property destroyed in disaster areas. If your business or investment property is destroyed in a Presidentially declared disaster area, the more restrictive related or similar use test for replacement property may be avoided. You may defer gain realized from the receipt of insurance proceeds by replacing the distroyed property with any tangible business property. The provision is retroactively applicable to disasters for which a Presidential declaration was made after December 31, 1994. *See* ¶18.22.

Charitable contribution of stock to private foundation. A deduction for fair market value is allowed on a donation of publically traded stock held long term to a private non-operating foundation if the contribution is made after June 30, 1996 and before June 1, 1997. *See* ¶ 14.6.

Damage awards. Tax-free treatment for damages is limited to physical injury or sickness. Damages for emotional distress that are not attributable to a physical injury or sickness, or to actual medical expenses, are taxable. These rules generally apply to awards received after August 20, 1996. All punitive damages are taxable except for punitive damages received in an action for wrongful death if state law in effect on September 13, 1995, restricted awards to punitive damages only. *See* ¶12.10.

Death benefits exclusion. The $5,000 exclusion for employer-provided death benefits is repealed for benefits received by beneficiaries of decedents dying after August 20, 1996. See ¶3.4, ¶7.28.

Diesel vehicles. For vehicles purchased after August 20, 1996, the tax credit for purchasers of diesel-powered cars, vans, and light trucks is repealed. *See* ¶40.23.

Earned Income Credit (EIC) reduction. For 1996, a credit is barred to a person with "disqualified" income over $2,200. See ¶25.10 - ¶25.13.

Electronic filing of employment taxes. Small businesses have a six-month reprieve from the requirement to begin depositing payroll taxes electronically as of January 1, 1997. The new date is July 1, 1997. The Electronic Federal Tax Payment System (EFTPS) applies to businesses that deposited more than $50,000 in federal employment tax in 1995.

Employer educational assistance exclusion. The income exclusion of up to $5,250 for benefits paid under a qualifying employer plan which had expired after 1994 has been retroactively extended. For undergraduate courses, the exclusion applies to courses in 1995 and 1996. The law states that the exclusion will expire for courses beginning after June 30, 1997, although a committee report indicates Congress's intent that the exclusion expire for courses beginning after May 31, 1997. For graduate courses, the reinstated exclusion applies only to courses beginning before July 1, 1996. The extension gives you a refund opportunity for taxes paid on assistance payments in 1995. *See* ¶ 3.6.

Excess distribution penalty. The 15% penalty on employer plan and IRA distributions over an annual threshold ($155,000 for 1996; $775,000 for a lump-sum) is suspended for 1997, 1998, and 1999. *See* ¶ 7.15 and ¶ 8.13.

Expatriation taxation. U.S. citizens who lose their citizenship for tax avoidance purposes are subject to special tax rules for 10 years after the loss of citizenship on or after February 6, 1995. The same rules apply to long-term residents of the United States whose U.S. residency is terminated. Citizenship and long-term residency are deemed to occur for tax avoidance reasons if either: (1) the individual's average annual federal income tax liability for the five tax years ending before the date of the loss or termination exceeds $100,000, or (2) the individual's net worth as of the date of the loss or termination is $500,000 or more.

Even if these dollar thresholds are not met, the expatriation tax rules apply unless the loss of citizenship or termination of residency did not have as a principal purpose the avoidance of tax.

FICA tip credit. A food business employer may claim a tax credit for FICA taxes paid on employee tips, whether or not the employee reports the tips. The credit is available for FICA taxes paid after December 31, 1993, regardless of when the services were performed. Beginning in 1997, the credit will apply without regard to whether the food or beverages are for consumption on or off the premises. Thus, the credit will apply to employees who deliver food or beverages. *See* ¶40.22.

Filing requirements for 1996. New income thresholds for filing are on page 2.

First-year expensing. Starting in 1997, the cap on the first-year expensing deduction increases over a seven-year period: In 1997 to $18,000; in 1998 to $18,500; in 1999 to $19,000; in 2000 to $20,000; in 2001 and 2002 to $24,000; and in 2003 and later to $25,000. *See* ¶42.3.

Hazardous duty area. Effective November 21, 1995, tax-free pay rules apply to service in Bosnia and Herzegovina, Croatia, and Macedonia. *See* ¶¶35.4 – 35.7.

Home storage of product samples. Expenses allocated to space in a personal residence used to store product samples for your business are deductible in taxable years beginning after December 31, 1995. *See* ¶40.12.

Independent contractor safe haven rule. If you establish a prima facie case that it was reasonable not to treat a worker as an employee under the safe haven rule (Section 530 of the 1978 Revenue Act), the burden of proof shifts to the IRS. You also must fully cooperate with reasonable IRS requests for information relevant to your treatment of the worker as an independent contractor under the safe haven. These provisions apply to disputes for years after 1996.

Installment agreements. Effective January 30, 1997, the IRS must notify taxpayers 30 days before altering, modifying, or terminating and installment agreement for any reason, except when tax collection is in jeopardy. *See* ¶48.8.

IRA withdrawals for medical expenses. After 1996, you may withdraw without penalty before age 59 $^{1}/_{2}$ amounts from an IRA if used to pay medical costs for yourself, spouse, or dependents that exceed 7.5% of your adjusted gross income. The withdrawal is subject to regular income tax.

Also, beginning in 1997, if you are unemployed for a period of at least 12 weeks, you may withdraw funds without penalty to pay for medical insurance for yourself, spouse, or dependents. *See* ¶8.12.

IRS interest abatement. Certain actions by IRS employees may result in an abatement of interest. The interest-free period after receiving notice and demand for payment has been extended. *See* ¶48.8.

Joint returns. The requirement for full payment of joint tax liability as a precondition to switching from separate filing to joint filing is repealed for tax years beginning after July 30, 1996. *See* ¶1.2.

Liens and Levies. New laws affect public notice of tax liens and levy-exempt property amounts. *See* ¶48.8.

Leasehold improvements. Lessors are allowed a deduction for the basis of improvements disposed of or abandoned at the end of the lease term. *See* ¶42.15.

Long-term care. Long-term care coverage may be provided tax free to employees after 1996. Medical expense deductions may be allowed for long-term care expenses and distributions from long-term care policies may be tax free. *See* ¶17.15.

Lump-sum distributions. The election to use five-year averaging is repealed starting in the year 2000. For those born before 1936, the right to elect 10-year averaging is not affected. *See* ¶7.2.

Luxury auto tax. The luxury tax set to expire in 2000 has been extended to December 31, 2002. Beginning with sales after August 27, 1996, the tax rate for the remainder of 1996 is 9%. The tax rate in 1997 is 8%; in 1998, 7%; in 1999, 6%; in 2000, 5%; in 2001, 4%; and in 2002, 3%.

Mandatory retirement distributions. You must begin to take distributions from a qualified company or self-employed Keogh plan by April 1 of the calendar year following the later of: (1) the calendar year in which you reach age 70 $^{1}/_{2}$, and (2) the calendar year in which you retire. If you are a more-than-five-percent owner, however, distributions must begin no later than April 1 of the calendar year following the year in which you reach age 70 $^{1}/_{2}$. *See* ¶7.13.

Medical Savings Accounts (MSAs). Medical Savings Accounts are intended to meet medical costs not covered by a high-deductible health plan and may be offered only by employers who on average had no more than 50 employees in either of the two preceding years and who provide high-deductible health plans. The annual deductible must be between $1,500 and $2,250 for individuals and between $3,000 and $4,500 for families. After 1996, a self-employed person may set up an MSA to supplement a high-deductible health plan and deduct payments to an MSA up to the same limits applied to employer provided plans. *See* ¶17.16.

Mileage allowance. The IRS mileage allowance is increased to 31 cents for 1996 business travel (¶43.1) and 10 cents per mile for travel to obtain medical care (¶17.9) and moving expenses (¶21.1).

Nondiscrimination rules. For plan years beginning after 1996, several nondiscrimination tests for qualified retirement plans have been modified. The family aggregation rules are repealed.

The highly compensated employee tests are reduced from five to two. An employee is considered highly compensated if he or she was either a more-than-five-percent owner of the corporation in the current or preceding year or had compensation in the preceding year of more than $80,000. Employers have the option of counting only employees earning more than $80,000 a year who are also in the top 20% of employees in terms of compensation as highly compensated employees.

Personal exemption increased. Deductions for personal exemptions are increased to $2,550 for 1996, subject to the phase-out rules for high-income taxpayers. *See* ¶22.15.

Postmark of private couriers. A private delivery service may be treated as being on par with the U.S. Postal Service for the purposes of proving a timely mailing of documents if the private courier company has been designated as qualifying by the IRS after July 30, 1996. *See* ¶38.1 and ¶48.8.

Prohibited transactions penalty. The initial-level excise tax on prohibited transactions is increased from 5% to 10% for transactions after August 20, 1996. *See* ¶41.9.

QDRO drafting. Drafting a QDRO that gives a spouse benefits from a qualified plan involves technical details which legal counsel must carefully review. A new law may ease the drafting problem by requiring the IRS to provide by 1997 sample language for inclusion in a QDRO that meets tax law requirements. *See* ¶7.12.

Responsible person penalty. The IRS is required to deliver notice at least 60 days before issuing a notice and demand to persons deemed to be "responsible" when withheld employment taxes are not paid. The notice requirement applies to proposed assessments made after June 30, 1996, unless the IRS determines that collection of the penalty is in jeopardy.

A federal cause of action is created for responsible persons seeking reimbursement from other responsible individuals who have yet to pay their proportionate share.

S corporations. Major S corporation changes are discussed at ¶45.14.

Self-employed's health insurance. The deduction increases to 40% of annual premium costs in 1997, 45% in 1998 through 2002, 50% in 2003, 60% in 2004, 70% in 2005, and 80% in 2006 and later years. *See* ¶17.6.

Self-employed plans. Starting in 1997, a self-employed plan of an owner does not have to be integrated with other qualified plans. *See* ¶41.1.

SIMPLE retirement plan. Businesses with 100 or fewer employees which have no other employer sponsored plan may set up a SIMPLE (savings incentive match plan for employees), beginning in 1997. A SIMPLE plan can either provide an IRA to which employees may make salary-reduction deferrals or be part of a qualified cash or deferred arrangement (401(k) plans). *See* ¶8.17.

Spousal IRA contribution. The maximum annual contribution for a married couple filing jointly where one spouse does not work is raised to $4,000, up from $2,250. This increase is effective for tax years beginning after December 31, 1996. *See* ¶8.3.

Standard deduction increase. Standard deduction amounts for 1996 returns are at ¶13.1.

State sponsored tuition prepayment plans. Under a new law, parents or other relatives who prepay a student's college tuition under a qualifying state plan do not have to pay gift tax. The student will be liable for income tax as withdrawals from the plan are made to pay eligible expenses. *See* ¶33.4.

Tax brackets adjusted for inflation. New 1996 tax brackets are at ¶23.2.

Tax-exempt organizations may set up 401(k) plans. For plan years starting after 1996, tax-exempt organizations may establish 401(k) plans. State or local governments may not set up a qualified 401(k) plan. However, a rural cooperative plan or Indian tribal government may do so. *See* ¶7.17.

Taxpayer Advocate. The Taxpayer Ombudsman is replaced with the position of Taxpayer Advocate to help individuals resolve differences with the IRS. *See* ¶48.8.

TIN for dependency exemption or child care credit. The IRS will disallow a dependency exemption if you fail to provide a correct taxpayer identification number (TIN) for a dependent. The TIN is the dependent's Social Security number. Similarly, the child or dependent care credit may not be claimed if the qualifying dependent's Social Security number is not reported on your return. The failure is treated as a mathematical or clerical error. This allows the IRS to assess additional tax due without sending you a notice of deficiency if you do not protest the assessment within 60 days of receiving notice from the IRS. These rules generally apply to 1996 returns, except that failure to provide a TIN for a dependent born in December of 1996 will not preclude you from getting a 1996 exemption or 1996 child care credit. *See* ¶22.14 and ¶25.1.

U.S. Savings Bonds used for tuition. The phase-out range for the savings bond tuition exclusion has been modified. *See* ¶33.3.

GLOSSARY OF TAX TERMS

Accelerated Cost Recovery System (ACRS). A statutory method of depreciation allowing accelerated rates for most types of property used in business and income-producing activities during the years 1981 through 1986. It has been superseded by Modified Cost Recovery System (MACRS) for assets placed in service after 1986; *see* ¶42.4.

Accelerated depreciation. Depreciation methods that allow faster write-offs than straight-line rates in the earlier periods of the useful life of an asset. For example, in the first few years of recovery, MACRS allows a 200% double declining balance write-off, twice the straight-line rate; *see* ¶42.5–¶42.8.

Accountable reimbursement plan. An employer reimbursement or allowance arrangement that requires you to adequately substantiate business expenses to your employer, and to return any excess reimbursement; *see* ¶20.31.

Accrual method of accounting. A business method of accounting requiring income to be reported when earned and expenses to be deducted when incurred. However, deductions generally may not be claimed until economic performance has occurred; *see* ¶40.2.

Acquisition debt. Debt used to buy, build, or construct a principal residence or second home and which generally qualifies for a full interest expense deduction; *see* ¶15.2.

Active participation. Test for determining deductibility of IRA deductions. Active participants in employer retirement plans are subject to IRA deduction phase-out rules if adjusted gross income exceeds certain thresholds; *see* ¶8.4.

Adjusted basis. A statutory term describing the cost used to determine your profit or loss from a sale or exchange of property. It is generally your original cost, increased by capital improvements, and decreased by depreciation, depletion, and other capital write-offs; *see* ¶5.24.

Adjusted Gross Income (AGI). Important tax term representing gross income *less* allowable adjustments, such as for IRA, alimony, and Keogh deductions. AGI determines whether various tax benefits are phased out, such as personal exemptions, itemized deductions, and the rental loss allowance; *see* ¶13.7.

Alimony. Payments made to a separated or divorced spouse as required by a decree or agreement. Qualifying payments are deductible by the payor and taxable to the payee; *see* ¶37.1–¶37.8.

Alternative minimum tax (AMT). A tax triggered if certain tax benefits reduce your regular income tax below the tax computed on Form 6251 for AMT purposes; *see* ¶23.3.

Amended return. On Form 1040X, you may file an amended return within a three-year period to correct a mistake made on an original return; *see* Chapter 38.

Amortizable bond premium. The additional amount paid over the face amount of an obligation which may be deducted under the rules of ¶4.17.

Amortization. Writing off an investment in intangible assets over the projected life of the assets; *see* ¶42.18.

Amount realized. A statutory term used to figure your profit or loss on a sale or exchange. Generally, it is sales proceeds plus mortgages assumed or taken subject to, less transaction expenses, such as commissions and legal costs; *see* ¶5.18.

Amount recognized. The amount of gain reportable and subject to tax. On certain tax-free exchanges of property, gain is not recognized in the year it is realized; *see* ¶6.1.

Annualized rate. A rate for a period of less than a year computed as though for a full year.

Annuity. An annual payment of money by a company or individual to a person called the annuitant. Payment is for a fixed period or the life of the annuitant. Tax consequences depend on the type of contract and funding; *see* ¶7.22–¶7.31.

Applicable federal rate. Interest rate fixed by the Treasury for determining imputed interest; *see* ¶4.31 and ¶4.32.

Appreciation in value. Increase in value of property due to market conditions. When you sell appreciated property, you pay tax on the appreciation since the date of purchase. When you donate appreciated property held long term, you may generally deduct the appreciated property; *see* ¶14.7.

Assessment. The IRS action of fixing tax liability that sets in motion collection procedures, such as charging interest, imposing penalties, and, if necessary, seizing property; *see* ¶47.3.

Asset. Anything owned that has cash or exchange value.

Assignment. The legal transfer of property, rights, or interest to another person called an assignee. You cannot avoid tax on income by assigning the income to another person.

At-risk rules. Limits loss deductions to cash investments and personal liability notes. An exception for real estate treats certain nonrecourse commercial loans as amounts "at risk"; *see* ¶10.17.

Attorneys' fee awards. Taxpayers who prevail in the Tax Court or other federal court may recover up to a certain amount for attorneys' fees, plus other litigation expenses, by showing that the IRS position was unreasonable; *see* ¶48.7.

Audit. An IRS examination of your tax return, generally limited to a three-year period after you file; *see* ¶48.1.

Averaging. Some retirees may use favorable averaging methods to compute tax on a lump-sum distribution if they participated in the plan for at least five years; *see* ¶7.3 and ¶7.4.

Away from home. A tax requirement for deducting travel expenses on a business trip. Sleeping arrangements are required for at least one night before returning home; *see* ¶20.3 and ¶20.6

Balloon. A final payment on a loan in one lump sum.

Basis. Generally, the amount paid for property. You need to know your "basis" to figure gain or loss on a sale; *see* ¶5.20.

Boot. Generally the receipt of cash or its equivalent accompanying an exchange of property. In a tax-free exchange, boot is subject to immediate tax; *see* ¶6.3.

Calendar year. A year that ends on December 31.

Cancellation of debt. Release of a debt without consideration by a creditor. Cancellations of debt are generally taxable; *see* ¶12.9.

Capital. The excess of assets over liabilities.

Capital asset. Property subject to capital gain or loss treatment. Almost all assets you own are considered capital assets except for certain business assets or works you created; *see* ¶5.6.

Capital expenses. Costs that are not currently deductible and that are added to the basis of property. A capital expense generally increases the value of property. When added to depreciable property, the cost is deductible over the life of the asset; *see* ¶40.7.

Capital gain or loss. The difference between amount realized and adjusted basis on the sale or exchange of capital assets. Long-term capital gains are given tax benefits as explained in Chapter 5. Capital losses are deducted first against capital gains, and then against up to $3,000 of other income; *see* ¶5.2 and ¶5.3.

Capital gain distribution. A mutual-fund distribution allocated to gains realized on the sale of fund portfolio assets. You report the distribution as long-term capital gain even if you held the fund shares short term; *see* ¶32.5.

Capital loss carryover. A capital loss that is not deductible because it exceeds the annual $3,000 capital loss ceiling. A carryover loss may be deducted from capital gains of later years plus up to $3,000 of ordinary income; *see* ¶5.3.

Capitalization. Adding a cost or expense to the basis of the property; *see* ¶40.7.

Carryback. A tax technique for receiving a refund of back taxes by applying a deduction or credit from a current tax year to a prior tax year. For example, a business net operating loss may be carried back for three years; *see* ¶40.17.

Carryforward. A tax technique of applying a loss or credit from a current year to a later year. For example, a business net operating loss may be carried forward 15 years instead of being carried back for three years; *see* ¶40.17.

Cash method of accounting. Reporting income when actually or constructively received and deducting expenses when paid. Certain businesses may not use the cash method; *see* ¶40.2.

Casualty loss. Loss from an unforeseen and sudden event that is deductible, subject to a 10% income floor and $100 reduction for personal losses; *see* ¶18.10.

Charitable contributions. An itemized deduction is allowed for donations to qualifying charities. For property donations, the deductible amount depends on the type of property and donee organization, your holding period, and in some cases how it is used; *see* Chapter 14.

Child and dependent credit. A credit of up to 30% based on certain care expenses incurred to allow you to work; *see* ¶25.1.

Child support. Payments to support a minor child generally to a custodial parent under a divorce or separation decree or agreement. The payments are not deductible; *see* ¶37.5.

Clifford trust. A short-term trust in which the principal is reserved by the grantor and current income is paid to the beneficiary. The tax-saving features of such trusts have been blocked by current tax rules; *see* ¶33.6.

Community income. Income earned in community property states and treated as belonging equally to husband and wife; *see* ¶1.9.

Condemnation. The seizure of property by a public authority for a public purpose. Tax on gain realized on many conversions may be deferred; *see* ¶18.18 and ¶18.25.

Constructive receipt. A tax rule that taxes income which is not received by you but which you may draw upon; *see* ¶2.1.

Consumer interest. Interest incurred on personal debt and consumer credit. Consumer interest is not deductible.

Convention. Rule for determining MACRS depreciation in the year property is placed in service. Either a half-year convention or mid-quarter convention applies; *see* ¶42.5–¶42.7.

Corporation. An entity organized under state law and generally treated as a separate taxpayer unless an S election is made; *see* ¶45.5.

Credit. A tax credit directly reduces tax liability, as opposed to a deduction that reduces income subject to tax.

Declining balance method. A rapid depreciation method determined by a constant percentage based on useful life and applied to the adjusted basis of the property. For example, a 40% declining balance rate applies to business automobiles, but it must be reduced by a half-year or mid-quarter convention; *see* ¶42.5 and ¶42.8.

Deductions. Items directly reducing income. Personal deductions such as for mortgage interest, state and local taxes, and charitable contributions are allowed only if deductions are itemized on Schedule A, but deductions such as for alimony, capital losses, moving expenses to a new job location, business losses, and IRA and Keogh deductions are deducted from gross income even if itemized deductions are not claimed; *see* ¶13.7.

Deferred compensation. A portion of earnings withheld by an employer or put into a retirement plan for distribution to the employee at a later date. If certain legal requirements are met, the deferred amount is not taxable until actually paid, for example, after retirement; *see* ¶2.8.

Deficiency. The difference between the tax assessed by the IRS and the amount reported on your return; *see* ¶47.1.

Defined benefit plan. A retirement plan that pays fixed benefits based on actuarial projections; *see* ¶41.2.

Defined contribution plan. A retirement plan that pays benefits based on contributions to individual accounts, plus accumulated earnings. Contributions are generally based on a percentage of salary or earned income; *see* ¶41.2.

Dependency exemption. A fixed deduction allowed to every taxpayer, except those who may be claimed as a dependent by another person. Extra exemption deductions are allowed for a spouse on a joint return and for each qualifying dependent. A deduction of $2,550 is allowed for each exemption claimed on 1996 returns, but the deduction is phased out for certain high income individuals; *see* ¶22.15.

Dependent. A person supported by another person. If certain tests are met, a dependency exemption may be claimed for the dependent; *see* Chapter 22.

Depletion. Deduction claimed for the use of mineral resources; *see* ¶9.15.

Depreciable property. A business or income-producing asset with a useful life exceeding one year; *see* ¶42.1.

Depreciation. Writing off the cost of depreciable property over a period of years, usually its class life or recovery period specified in the tax law; *see* ¶42.4.

Depreciation recapture. An amount of gain on the sale of certain depreciable property that is treated as ordinary income, rather than capital gain. Recapture is computed on Form 4797; *see* ¶44.1 and ¶44.2.

Disaster losses. Casualty losses such as from a storm, in areas declared by the President to warrant federal assistance. An election may be made to deduct the loss in the year before the loss or the year of the loss; *see* ¶18.2.

Dividend. A distribution made by a corporation to its shareholders generally of company earnings or surplus. Most dividends are taxable but exceptions are explained in Chapter 4.

Earned income. Compensation for performing personal services. You must have earned income for a deductible IRA; *see* ¶8.2, or to claim the earned income credit; *see* ¶25.10.

Earned income credit. A credit allowed to taxpayers with earned income or adjusted gross income (AGI) below certain thresholds; *see* ¶25.10.

Estate tax. Imposed if the value of a decedent's taxable estate, after deductions, exceeds $600,000; *see* ¶39.5.

Estimated tax. Advance payment of current tax liability based either on wage withholdings or installment payments of your estimated tax liability. To avoid penalties, you generally must pay to the IRS either 90% of your final tax liability, or either 100% or 110% of the prior year's tax liability, depending on your adjusted gross income; *see* ¶27.2 and ¶27.5.

Excess distributions. Retirement payments exceeding specified limits are subject to a 15% penalty unless rolled over to an IRA or other exceptions are met; *see* ¶7.15.

Exemption. *See* **Dependency exemption.**

Fair market value. What a willing buyer would pay to a willing seller when neither is under any compulsion to buy or sell.

Fiduciary. A person or corporation such as a trustee, executor, or guardian who manages property for another person.

First-year expensing. In 1996, a deduction of up to $17,500 (or $37,500 for qualifying businesses in an enterprise zone) of the cost of business equipment in the year placed in service In 1997, the deduction increases to $18,000); *see* ¶42.3.

Fiscal year. A 12-month period ending on the last day of any month other than December. Partnerships, S corporations, and personal service corporations are limited in their choice of fiscal years and face special restrictions; *see* Chapter 45.

Flexible spending arrangements. A salary reduction plan which allows employees to pay for enhanced medical coverage or dependent care expenses on a tax-free basis; *see* ¶3.14.

Foreign earned income exclusion. Up to $70,000 of foreign earned income is exempt from tax if a foreign residence or physical presence test is met; *see* ¶36.2.

Foreign tax credit. A credit for income taxes paid to a foreign country or U.S. possession; *see* ¶36.14.

401(k) plan. A deferred pay plan, authorized by section 401(k) of the Internal Revenue Code, under which a percentage of an employee's salary is withheld and placed in a savings account or the company's profit-sharing plan. Income accumulates on the deferred amount until withdrawn by the employee at age 59½ or when the employee retires or leaves the company; *see* ¶7.17.

Gift tax. Gifts in excess of a $10,000 per donee annual exclusion are subject to gift tax, but the tax may be offset by a unified gift and estate tax credit; *see* ¶33.1.

Grantor trust rules. Tax rules that tax the grantor of a trust on the trust income; *see* ¶33.6.

Gross income. The total amount of income received from all sources before exclusions and deductions.

Gross receipts. Total business receipts reported on Schedule C or Schedule C-EZ before deducting adjustments for returns and allowances and cost of goods sold; *see* ¶40.5.

Group-term life insurance. Employees are not taxed on up to $50,000 of group-term coverage; *see* ¶3.3.

Head of household. Generally, an unmarried person who maintains a household for dependents and is allowed to compute his or her tax based on head of household rates, which are more favorable than single person rates; *see* ¶1.10.

Hobby loss. Hobby expenses are deductible only up to income from the activity; loss deductions are not allowed; *see* ¶40.9.

Holding period. The length of time which an asset is owned and which generally determines long- or short-term capital gain treatment; *see* ¶5.13–¶5.16.

Home equity debt. Debt secured by a principal residence or second home to the extent of the excess of fair market value over acquisition debt. An interest deduction is generally allowed for home equity debt up to $100,000 ($50,000 if married filing separately); *see* ¶15.3.

Imputed interest. Interest deemed earned on seller-financed sales or low-interest loans, where the parties' stated interest rate is below the applicable IRS federal rate; *see* ¶4.31 and ¶4.32.

Incentive stock option. Options meeting tax law tests that defer tax on the option transaction until the obtained stock is sold; *see* ¶30.11.

Income in respect of a decedent. Income earned by a person before death but taxable to an estate or heir who receives it; *see* ¶1.12 and ¶11.4.

Independent contractor. One who controls his or her own work and reports as a self-employed person; *see* Chapters 40 and 46.

Individual retirement account (IRA). A retirement account to which up to $2,000 may be contributed annually, but deductions for the contribution are restricted if you are covered by a company retirement plan. Earnings accumulate tax free on IRA contributions. Restrictions and limits are discussed in Chapter 8.

Innocent spouse. A spouse who claims that he or she should not be liable on a joint return because of ignorance of the other spouse's omission of income or claiming of excessive write-offs; *see* ¶1.4.

Installment sale. A sale of property that allows for tax deferment if at least one payment is received after the end of the tax year in which the sale occurs. The installment method does not apply to year-end sales of publicly traded securities. Dealers may not use the installment method. Investors with very large installment balances could face a special tax; *see* ¶5.25.

Intangible assets. Intangible assets that come within Section 197, such as goodwill, are amortizable over a 15-year period; *see* ¶42.18.

***Inter vivos* or lifetime trust.** A trust created during the lifetime of the person who created the trust. If irrevocable, income on the trust principal is shifted to the trust beneficiaries; *see* ¶33.6.

Investment in the contract. The total cost investment in an annuity. When annuity payments are made, the portion allocable to the cost investment is tax free; *see* ¶7.22 and ¶7.27.

Investment interest. Interest or debt used to carry investments, but not including interest expense from a passive activity. Deductions are limited to net investment income; *see* ¶15.10.

Involuntary conversion. Forced disposition of property due to condemnation, theft, or casualty. Tax on gain from involuntary conversions may be deferred if replacement property is purchased; *see* ¶18.19.

Itemized deductions. Items, such as interest, state and local taxes, charitable contributions, and medical deductions, claimed on Schedule A of Form 1040. Itemized deductions are subtracted from adjusted gross income to arrive at taxable income; *see* Chapter 13. The amount of itemized deductions is also subject to a 3% reduction when adjusted gross income exceeds certain limits; *see* ¶13.8.

Joint return. A return filed by a married couple reporting their combined income and deductions. Joint return status provides tax savings to many couples; *see* ¶1.3.

Joint tenants. Ownership of property by two persons. When one dies, the decedent's interest passes to the survivor; *see* ¶33.5.

Keogh plan. Retirement plan set up by a self-employed person, providing tax-deductible contributions, tax-free income accumulations until withdrawal, and favorable averaging for qualifying lump-sum distributions; *see* Chapter 41.

Kiddie tax. The tax on the investment income of a dependent child under age 14 in excess of $1,300, based on the parents' marginal tax rate and computed on Form 8615; *see* ¶24.3.

Legally separated. A husband and wife who are required to live apart from each other by the terms of a decree of separate maintenance. Payments under the decree are deductible by the payor and taxable to the payee as alimony; *see* ¶37.2.

Like-kind exchange. An exchange of similar assets used in a business or held for investment on which gain may be deferred; *see* ¶6.1.

Long-term capital gain or loss. Gain or loss on the sale or exchange of a capital asset held for more than one year; *see* ¶5.2 and ¶5.13.

Lump-sum distribution. Payments within one tax year of the entire amount due to a participant in a qualified retirement plan because of retirement, separation from service, reaching age 59 ½, death, or, in the case of a self-employed person, disability or reaching age 59 ½. Qualifying lump sums may be directly rolled over tax free, or, in some cases, eligible for current tax under a favorable averaging method; *see* ¶7.2.

Luxury automobile limits. Ceiling placed on annual depreciation deductions for autos used for business; *see* ¶43.3 and ¶43.4.

Marital deduction. An estate tax and gift tax deduction for assets passing to a spouse. It allows estate and gift transfers completely free of tax; *see* ¶39.6.

Market discount. The difference between face value of bond and lower market price, attributable to rising interest rates. On a sale, gain on the bond is generally taxed as ordinary income to the extent of the discount; *see* ¶4.20.

Material participation tests. Rules for determining whether a person is active in a business activity for passive activity rule purposes. Unless the tests are met, passive loss limits apply; *see* ¶10.6.

Miscellaneous itemized deductions. Generally, itemized deductions for job and investment expenses subject to a 2% adjusted gross income floor; *see* Chapter 19.

Modified ACRS (MACRS). Depreciation methods applied to assets placed in service after 1986. MACRS is less favorable than prior ACRS system; *see* ¶42.4.

Mortgage interest. Fully deductible interest on up to two residences if acquisition debt secured by home is $1 million or less, and home equity debt is $100,000 or less; *see* ¶15.1.

Moving Expenses. Certain expenses of moving to a new job location are deductible if distance and time tests are met; *see* Chapter 21.

Net operating loss. Business loss which exceeds current income and which may be carried back against income of three prior years and carried forward as a deduction from future income for 15 years until eliminated; *see* ¶40.17.

Nonperiodic distributions. A 20% withholding rule applies to nonperiodic distributions, such as lump-sum distributions, paid directly to employees from an employer plan; *see* ¶7.8 and ¶26.11.

Nonrecourse financing. Debt on which a person is not personally liable. In case of nonpayment, the creditor must foreclose on property securing the debt. At-risk rules generally bar losses where there is nonrecourse financing, but an exception applies to certain nonrecourse financing for real estate; *see* ¶10.17.

Nonresident alien. A person who is not a United States citizen or a permanent resident. Tax is generally limited to income from U.S. sources; *see* ¶1.14.

Ordinary and necessary. A statutory requirement for the deductibility of a business expense; *see* ¶40.5.

Ordinary income. Income other than capital gains.

Ordinary loss. A loss other than a capital loss.

Original issue discount (OID). The difference between the face value of a bond and its original issue price. OID is reported on an annual basis as interest income; *see* ¶4.19.

Partnership. An unincorporated business or income-producing entity organized by two or more persons. A partnership is not subject to tax but passes through to the partners all income, deductions, and credits, according to the terms of the partnership agreement; *see* Chapter 45.

Passive activity loss rules. Rules that limit the deduction of losses from passive activities to income from other passive activities. Passive activities include investment rental operations or businesses in which you do not materially participate; *see* ¶10.1.

Patronage dividend. A taxable distribution made by a cooperative to its members or patrons.

Pension. Payments to employees from an employer-funded retirement plan for past services; *see* ¶7.25.

Percentage depletion. A method that applies a fixed percentage to the gross income generated by mineral property; *see* ¶9.15.

Personal exemption. An automatic exemption given to a taxpayer unless he or she may be claimed as a dependent by another taxpayer. For 1996, the exemption amount is $2,550. Exemptions are phased out for certain high income taxpayers; *see* ¶22.15.

Personal interest. Tax term for interest on personal loans and consumer purchases. Such interest is not deductible.

Placed in service. The time when a depreciable asset is ready to be used. The date fixes the beginning of the depreciation period; *see* ¶42.5.

Points. Charges to the homeowner at the time of the loan. A point is equal to 1 percent. Depending on the type of loan, points may be currently deductible or amortized over the life of the loan; *see* ¶15.8.

Premature distributions. Withdrawals before age 59½ from qualified retirement plans are subject to penalties unless specific exceptions are met; *see* ¶7.14.

Principal residence. On a sale of a principal residence, you may defer tax on your profit if you buy a replacement within two years; *see* ¶29.3 and ¶29.4. On a sale of a principal residence at or after age 55, a $125,000 exclusion may be available; *see* ¶29.14.

Probate estate. Property held in a decedent's name passing by will; *see* ¶39.1.

Profit-sharing plan. A defined contribution plan under which the amount contributed to the employees' accounts is based on a percentage of the employer's profits; *see* ¶8.5 and ¶41.2.

Provisional income. If your provisional income exceeds a base amount, part of your Social Security benefits may be subject to tax. To figure provisional income, *see* ¶34.3.

Qualified charitable organization. A nonprofit philanthropic organization that is approved by the U.S. Treasury to receive charitable contribution deductions; *see* ¶14.1.

Qualified plan. A retirement plan that meets tax law tests and allows for tax deferment and tax-free accumulation of income until benefits are withdrawn. Pension, profit-sharing, stock bonus, employee stock ownership, and Keogh plans and IRAs may be qualified plans; *see* Chapters 7, 8, and 41.

Qualifying widow or widower. A filing status entitling the taxpayer with dependents to use joint tax rates for up to two tax years after the death of a spouse; *see* ¶1.6.

Real estate investment trust (REIT). An entity that invests primarily in real estate and mortgages and passes through income or loss to investors; *see* ¶31.1.

Real estate professional. An individual who, because of his or her real estate activity, qualifies to deduct rental losses from nonpassive income; see ¶10.3.

Real property. Land and the buildings on land. Buildings are depreciable; *see* ¶42.13 and ¶42.16.

Recognized gain or loss. The amount of gain or loss to be reported on a tax return. Gain may not be recognized on certain exchanges of property; *see* ¶6.1.

Recovery property. Tangible depreciable property placed in service after 1980 and before 1987 and depreciable under ACRS; *see* ¶42.11 and ¶42.16.

Refundable tax credit. A credit that entitles you to a refund even if you owe no tax for the year.

Residence interest. Term for deductible mortgage interest on a principal residence and a second home; *see* ¶15.1.

Residential rental property. Real property in which 80% or more of the gross income is from dwelling units. Under MACRS, depreciation is claimed over 27.5 years under the straight-line method; *see* ¶42.13.

Return of capital. A distribution of your investment that is not subject to tax unless the distribution exceeds your investment; *see* ¶4.11.

Revocable trust. A trust that may be changed or terminated by its creator or another person. Such trusts do not provide an income tax savings to the creator; *see* ¶33.6.

Rollover. A tax-free reinvestment of a distribution from a qualified retirement plan into an IRA or other qualified plan within 60 days; *see* ¶7.3, ¶7.8, and ¶8.10.

Royalty income. Amounts received for the use of property such as mineral property, a book, a movie, or a patent; *see* ¶9.11.

Salvage value. The estimated value of an asset at the end of its useful life. Salvage value is ignored by ACRS and MACRS rules.

S corporation. A corporation that elects S status in order to receive tax treatment similar to a partnership; *see* ¶45.5.

Scholarships. Grants to degree candidates receive tax-free treatment if awarded after August 16, 1986, and used for tuition and course-related expenses, but not room and board. More favorable exclusion rules apply to awards made before August 17, 1986; *see* ¶12.4.

Section 179 deduction. year expensing deduction, in 1996 up to $17,500, allowed for investments in depreciable business equipment in the year the property is placed in service. The deduction may be as high as $37,500 for qualifying businesses in an enterprise zone; *see* ¶42.3.

Section 457 plan. Deferred compensation plan set up by state or local government, or tax-exempt organization, that allows tax-free deferrals of salary, generally up to the lesser of $7,500 or one-third of pay; *see* ¶7.21.

Section 1231 property. Depreciable property used in a trade or business and held long term. All Section 1231 gains and losses are netted; a net gain is treated as capital gain, a net loss as an ordinary loss; *see* ¶44.8.

Self-employed person. An individual who operates a business or profession as a proprietor or independent contractor and reports self-employment income on Schedule C; *see* Chapters 40 and 46.

Self-employment tax. Tax paid by self-employed persons to finance Social Security coverage. In 1996, there are two rates. A 12.4% rate applies to a taxable earnings base of $62,700 or less; and a 2.9% rate on all net earnings; *see* Chapter 46.

Separate return. Return filed by married person who does not file a joint return. Filing separately may save taxes where each spouse has separate deductions, but certain tax benefits require a joint return; *see* ¶1.2.

Short sale. Sale of borrowed securities made to freeze a paper profit or to gain from a declining market; *see* ¶30.6.

Short tax year. A tax year of less than 12 months. May occur with the startup of a business or change in accounting method.

Short-term capital gain or loss. Gain or loss on the sale or exchange of a capital asset held one year or less; *see* ¶5.13.

Simplified employee plan (SEP). IRA-type plan set up by an employer, rather than the employee. Salary reduction contributions may be allowed to plans of small employers; *see* ¶8.16.

Single. The filing status of an individual who is not married on December 31 of the year for which the return is filed; *see* ¶1.1.

Standard deduction. A fixed deduction allowed to taxpayers who do not itemize deductions. The amount depends on filing status, age, and blindness; *see* ¶13.1.

Standard mileage rate. A fixed rate allowed by the IRS for business auto expenses in place of deducting actual expenses; *see* ¶43.1.

Statutory employees. Certain employees, such as full-time life insurance salespersons, may report income and deductions on Schedule C rather than on Schedule A, as a miscellaneous itemized deduction; *see* ¶40.5.

Stock dividend. A corporate distribution of additional shares of its stock to its shareholders; *see* ¶4.6.

Stock option. A right to buy stock at a fixed price; *see* ¶30.11.

Straddle. Taking an offsetting investment position to reduce the risk of loss in a similar investment; *see* ¶30.9.

Straight-line method. A method of depreciating the cost of a depreciable asset on a pro rata basis over its useful life; *see* ¶42.9, ¶42.12.

Tangible personal property. Movable property, such as desks, computers, machinery, and autos. Depreciable over a five-year or seven-year period; *see* ¶42.4.

Taxable income. Net income after claiming all deductions from gross income and adjusted gross income, such as IRA deductions, itemized deductions, or the standard deduction, and personal exemptions; *see* ¶23.1.

Tax deferral. Shifting income to a later year, such as where you defer taxable interest to the following year by purchasing a T-bill or savings certificate maturing after the end of the current year; *see* Chapter 4. Investments in qualified retirement plans provide tax deferral (*see* Chapters 7, 8, and 41). Deferral on gain from sale of your home is mandatory if you buy a qualifying replacement home within two years; *see* ¶29.4.

Tax home. The area of your principal place of business or employment. You must be away from your tax home on a business trip to deduct travel expenses; *see* ¶20.6–¶20.9.

Tax identification number. For an individual, his or her Social Security number; for businesses, fiduciaries, and other nonindividual taxpayers, employer identification number.

Tax preference items. Items that may subject a taxpayer to the alternative minimum tax (AMT); *see* ¶23.6.

Tax rate schedules. Used by taxpayers with taxable incomes of $100,000 or more; *see* ¶23.2.

Tax-sheltered annuity. A type of retirement annuity offered to employees of charitable organizations and educational systems, generally funded by employee salary-reduction contributions; *see* ¶7.20.

Tax tables. Used by taxpayers with taxable incomes of less than $100,000 to look up their tax; *see* page 663.

Tax year. A period of 12 months for reporting income and expenses; *see* ¶40.3.

Tenancy by the entireties. A joint tenancy in real property in the name of both husband and wife. On the death of one tenant, the survivor receives entire interest.

Tenants in common. Two or more persons who have undivided ownership rights in property. Upon death of a tenant, his or her share passes to his or her estate, rather than to the surviving tenants.

Testamentary trust. A trust established under a will; *see* ¶33.6.

Trust. An arrangement under which one person transfers legal ownership of assets to another person or corporation (the trustee) for the benefit of one or more third persons (beneficiaries); *see* ¶11.2 and ¶33.6.

Useful life. For property not depreciated under ACRS or MACRS, the estimate of time in which a depreciable asset will be used.

Vacation homes. The tax law limits deductions for vacation homes, broadly defined as any dwelling unit used by the owner or the owner's relatives for more than a specified period; *see* ¶9.7.

Wash sales. Sales on which losses are disallowed because you recover your market position within a 61-day period; *see* ¶30.7.

Withholding. An amount taken from income as a pre-payment of an individual's tax liability for the year. In the case of wages, the employer withholds part of every wage payment. Backup withholding from dividend or interest income is required if you do not provide the payer with a correct taxpayer identification number. Withholding on pensions and IRAs is automatic unless you elect to waive withholding; *see* Chapter 26.